Bonneville Power Administration
Rates Policy Workshop

March 14, 2003

BPA Rates Hearing Room, Portland, Oregon
Approximate attendance: 70 people present; 8 by phone

Paul Norman (BPA) opened the meeting with an acknowledgement that a Federal Register Notice (FRN) came out this week announcing the Safety Net Cost Recovery Adjustment Clause (SN CRAC). We have said all along that "unless and until" BPA lands on a better approach, the SN CRAC proceeding is moving forward, he said. But we did not expect the FRN to come out so soon, Norman stated. The notice says basically what the rates staff has been talking about, he added.

Norman outlined an agenda for the meeting that included a review of analyses BPA conducted of scenarios posed by the customers. He noted that **Rick Lovely (Grays Harbor PUD)** would likely want to talk about the materials he posted in the meeting room. It seems like the situation has been predetermined since you've announced the rate proposal, Lovely responded. He said the graphs he posted display BPA's cost information formatted on "a true scale."

We announced in February that we were initiating the SN CRAC process, and we had technical workshops on a proposal like the one that appeared in the FRN yesterday, Norman said. The customers asked to have meetings about a different approach, and we agreed, he said. But unless and until we have a promising alternative, we have to move the formal SN CRAC forward, Norman stated. We are on two tracks here, he added.

The dates in the FRN indicate there will be only 10 days between a draft and final Record of Decision and the brief on exceptions, **Erick Johnson (PNGC Power)** pointed out. **Peter Burger (BPA)** said the schedule in the FRN is a proposal and subject to change. We'll have a prehearing conference at the start of the rate case, and the attorneys will sit down and work out a schedule, he indicated.

John Saven (NRU) asked if BPA had written materials on what it shared with bond rating agencies about the customer proposal. **Jim Curtis (BPA)** said BPA did not make a presentation to the agencies on the customer proposal. They have access to BPA's web site, where the proposal is posted, he added. Standard & Poors did a point-by-point rebuttal of the customer proposal, **Kevin Clark (Seattle)** said. Curtis indicated he would provide addresses for web sites where the rating agencies posted their reports.

<u>Alternative Proposal</u>

Norman said Attachment #1 in the BPA handout is analysis of the Treasury Payment Probability (TPP) for two alternative financial scenarios Saven posited at the last meeting. The analysis is based on the assumption there would be no SN CRAC from 2003 to 2006, he added. (The handout, which describes the scenarios and contains other attachments discussed later in the meeting, is posted on the BPA web site at http://www.bpa.gov/power/psp/rates/meetings/030314ws/index.shtml.)

Saven explained that at the March 7 meeting, BPA presented a scenario based on a single element of the customers' suggestions: using $100 million in Energy Northwest (ENW) refinancing proceeds to bolster the TPP. BPA concluded that scenario could be "a financial disaster" and lead to an SN CRAC as high as 62 percent in 2004, he said. But the analysis did not include several other elements of the customer proposal, so we asked BPA to include those and run additional scenarios, Saven stated.

He went on to describe the assumptions BPA incorporated into the new analyses, including an additional $23 million in revenue and significant cost cuts. A second scenario adds in deferral of $55 million in benefit payments to investor-owned utilities (IOUs) in 2004 and settlement of IOU-related litigation that would reduce BPA costs another $67 million in 2004, Saven explained. The results of the analysis lead me to believe "the disaster could be averted," he stated.

He next provided background on how the NRU alternative evolved. BPA identified a $5.3 billion cost issue since its last rate period, and we looked at the situation and saw that over 80 percent of the problem related to the system augmentation purchases and payments to the IOUs, Saven said. BPA indicated it would have a $920 million net revenue loss for FY02-06, and our impression was that 60 percent of this or $550 million is associated with hydro supply and secondary forecasts for the FY04-06 period, he continued.

We looked at BPA's SN CRAC proposal, which produces a 56 percent TPP for 2004 and worked to come up with something that would give BPA at least that level of payment probability, Saven explained. We came up with a $754 million package of cuts and additional revenues that would eliminate the SN CRAC for now, defer deliberation until later in the year, and provide a year-to-year review of the need for the CRAC, he stated.

Saven outlined concerns BPA staff expressed about his initial suggestions, including whether the agency could achieve the cost cuts, whether the customers' market price and 4(h)(10)(c) assumptions could be counted on, and the impacts on cash flow if an SN CRAC did not take effect on October 1. In response, we came up with two new scenarios that eliminated $75 million in higher revenues and 4(h)(10)(c) credits and did not assume the settlement of IOU issues, he said. That scenario resulted in the 96 percent TPP in FY03 and the 52 percent in FY04, Saven reported. Since the IOUs have previously offered the continued deferral of payments and there is great momentum to settle the litigation, it is reasonable to assume that BPA will not be liable for those obligations in 2004, according to Saven. When we add those assumptions into the scenario, the TPP is 74 percent, he indicated. The results show that we have a stronger package for getting through 2004 than BPA, Saven stated.

He acknowledged that the customer proposal depends on BPA and the federal family resolving issues and on settling the IOU litigation. But the proposal gives parties time to work through the issues in advance of an SN CRAC and gives the Northwest economy a chance to recover at a time when things are particularly bleak, Saven pointed out. In conclusion, we think we have a proposal that is responsive to BPA's situation, he stated. And we recognize that if "the gloomy scenario" materializes, we may need an SN CRAC in FY05-06, he summed up. That's something I can live with, Saven added.

In your Scenario 2, the $67 million obligation goes away, but BPA keeps the money and it somehow moves out of the Load-Based (LB) CRAC? Wright asked. Yes, Saven said. Who needs to agree in order to make that happen? Wright asked.

Terry Mundorf (WPAG) said BPA is one party that would have to agree. We have discussed the mechanics, and there are a couple of ways to accomplish it, he said. Our view is that the retention of funds by BPA – money that would be a substitute for the SN CRAC – should be done in a way that does not cause cost shifts, he stated. It would be done through a rate case settlement and would require the agreement of the bulk, if not all, customers, Mundorf stated.

If everyone doesn't get on board with this, would we still have the SN CRAC process? Wright asked. You'd still be having a process, but not necessarily the one outlined in the FRN, Mundorf responded. So it's possible you could bring us a settlement on this? Wright asked. We have discussed the mechanics, Mundorf responded. We talked with most of the people "who have money on the table," and we have a lot of ideas, he said. There are ways of achieving this, and the customers who have met "are ready, willing and able to pursue it to finality," Mundorf stated.

What about FY05-06 if the settlement doesn't work out? Wright asked. In that case, unless something dramatic happens in the power market, you would be looking at an SN CRAC, Saven acknowledged. I think we can settle the issues as we've proposed, but if not, the agency needs to have the ability to impose an SN CRAC, and it may be larger than it would otherwise have been, he added.

If we delay the SN CRAC and hope that things get better, what happens if they don't? Wright asked. How bad will the situation be then? he asked.

The customer proposal is a chance to get through this without the SN CRAC, Lovely responded. If the economy recovers, we might be looking at a whole different set of numbers, he said. But the SN CRAC right now could bring "an avalanche of destruction" that we cannot tolerate, Lovely stated.

You haven't analyzed the timing of when the SN CRAC increase goes into effect, **Steve Weiss (NWEC)** said. My suggestion would be to take a look at your situation in July or August, rather than October, he said. If need be, you could have an increase that takes effect January 1 or February 1, Weiss suggested. Burger said BPA had looked at that construct, but determined it presented a procedural problem and the timing would not fit with the GRSPs.

We would not close the SN CRAC process, but defer it, Weiss said, adding that should alleviate the procedural problem. Part of the settlement could be to agree to reopen the proceeding earlier, he stated. There are just a few months "between the two sides," and maybe we can bridge that gap, Weiss said. The customers and NWEC like the approach of determining year to year whether the SN CRAC is needed "because things change," he added.

We are interested in how you could accomplish the mechanics of a settlement, **Doug Brawley (PNGC Power)** stated. We are talking about a large change to the GRSPs and in my view, that would take unanimous approval by the customers, he said. Brawley pointed out that the deferral and elimination of payments to the IOUs would bring the TPP to 74 percent. An additional "strong look at costs" could accomplish the same thing, he said. The Saven proposal doesn't go very far with costs cuts, and we think it could be more aggressive, Brawley stated.

Saven's proposal is a plea not to impose an increase now, but to use other tools to get through the next two years, Mundorf said. We realize this could mean a higher SN CRAC in the out-years, he stated. My clients understand the consequences, Mundorf said, and they are saying, delay the pain and you may avoid it entirely. It's not "a great alternative," but there aren't any, he acknowledged. The possibility of a higher increase later is a gamble we are willing to take, Mundorf added.

We shouldn't let process and mechanics bog us down and get in the way of progress, Clark advised. We are trying to rebuild trust between "the stewards of the system and those who pay the bills," he said. The perception is that automatic mechanisms to raise rates take away the incentive to control costs, Clark stated. The FRN says it could take $1.9 billion in additional revenue over the next three years collected through an automatic rate increase, he pointed out. There isn't the political credibility at the moment for the agency or the utilities to have that happen, he added. Let's try to do this a year at a time, Clark urged. We need to keep the pressure on BPA to get all possible cost cuts, and an automatic adjustment formula doesn't do that, he indicated. We feel we have been "jerked around" about BPA's commitment to get its internal spending to 2001 actuals, according to Clark. This is about building trust and limiting automatic rate increases, he said, adding that the FRN proposal is "totally unacceptable" for rebuilding trust.

Jim Luce (State of Washington) said Governor Locke feels strongly that BPA needs to undertake the "Priorities of Government" process to determine where cuts could be made to the agency's budget. In the last 20 years, BPA has grown tremendously, partly because of the Northwest Power Act and partly because money was available to spend on programs – programs that made a lot of sense, he said. The challenge now is that while the programs may still make sense, we can no longer afford them, Luce pointed out. The Priorities of Government process would go a long way to building trust with customers, he advised.

Wright acknowledged the value of the Priorities of Government in terms of "creating transparency" and said the agency is looking into it.

Is your commitment to hold internal spending to the 2001 actuals or are there some qualifiers with revenue offsets? Rob Sirvaitis (PRM) asked. We have tried to be consistent in saying that our commitment to cost control includes looking at revenue offsets to costs, Norman responded. Specifically, there is about $7 million annually in revenue improvements, or $30 million total, that we have been including as offsets, he stated. The revenue improvements are related to increased hydro output, and the numbers are consistent with what we estimate we've gained in efficiency improvements, Norman explained. As to whether the revenue is included in the model runs for TPP, we make estimates of hydro system output that try to capture the efficiencies, and in that sense, the $7 million annually is included, he said. But can you find a line item related to that in model runs? Probably not, Norman acknowledged.

So there's $30 million some place, but you can't track it, Clark said. See how this doesn't build trust? he asked, pointing out that customers are being asked to pay hundreds of millions in additional rates, but BPA can't account for revenues. It's going to be hard to get there from here, Clark added.

It seems like we really need to get to the $67 million plus $55 million in reductions for FY04, which requires the agreement of all parties, Wright stated. Why would we call that question today and stop the SN CRAC, rather than get the rate increase in place and then make an adjustment if the agreement is reached? Wright asked.

We want to stop the SN CRAC now, Saven replied. It creates a better environment for resolving the issues related to the $55 million and the $67 million, he stated. I am optimistic about it, Saven said. I have seen how committed people are to work on it, and I've seen the previous offers for the deferrals, he added. My experience working with the IOUs and with your staff says these things can be and should be resolved, Saven stated. In addition, there is the problem of trying to work on the long-term issues and simultaneously dealing with the SN CRAC process, he pointed out.

The same people who would be putting in time to resolve the long-term issues are the same people who have to be involved in the SN CRAC rate case, Mundorf agreed. The FRN indicates there will be an SN CRAC deadline about every four days, and that doesn't allow us time to work on both processes, he said. Clearly, we think spending time on alleviating the outlays and increasing BPA's revenues is the best course – the 7(i) process doesn't add to resolving the long-term problems, Mundorf indicated.

You can't disregard the fact that the paths offer different incentives, **Paul Murphy (Golden NW)** said. It's painful to cut costs, and putting the SN CRAC in place and then making the cuts, changes the incentives, he said. In my view, you need to go to ENW, the Corps, and the Bureau to discuss cost cuts, Murphy stated. Why would they agree to cut their budgets if you have a rate increase in place? he asked.

We’ve been trying to resolve the IOU problem since last June, Wright pointed out. Now there is movement toward doing that, and I think it’s because we initiated the SN CRAC process, he said. If we stop the SN CRAC, do we lose the pressure to get these issues resolved in a timely way? Wright asked.

I don’t think so, Murphy said. The solution lies with BPA cutting its internal costs and going its generating partners to achieve cuts, he said. That’s where the solution ultimately has to come from – reducing costs, Murphy continued. When you set the costs in the rate case, which were far lower than your costs now, I assume you believed you could live within them, he said. That’s why I think you need to go back and figure out how to do it, Murphy indicated.

I understand the magnitude of the financial issues and don’t need the SN CRAC as incentive to resolve them, Saven stated. The region is poised to make the IOU issues go away, and you need to trust our judgment that we can get it done, he urged. We don’t need the incentive of the SN CRAC; it gets in the way of doing other work, Saven said.

Do you assume the IOU benefit level post-2006 has to be resolved now or just FY03-06? Wright asked. To settle this, we have to resolve issues associated with the litigation, so we need to look at the contracts and possibly get into FY07-11, Saven answered.

The litigation was filed to challenge a contract, so to settle it, we need to address concerns about the contract from the standpoint of the parties that signed it and those that challenged it, Mundorf elaborated. We don’t know yet what period we would need to address, he acknowledged, but that’s different than saying the situation requires clarity for the next 20 years.

For 10 years? Wright asked. There is an interest in that, but I’m reluctant to guess what will be required, Mundorf said. One reason we are here is because of the obligation BPA took on, he said.

I have a problem with the “bet-on-the-come” strategyWright stated. What is the likelihood you can resolve only the FY03-06 part of this, or will you need to go beyond FY06? he asked. If we get into post-06 level of benefits, there are many parties with issues, and the chances for success will dwindle in the timeframe we are talking about, Wright stated.

Ed Sheets (CRITFC/Yakama Nation) said his clients are concerned that BPA has been betting on the come for several years. They believe BPA was being too optimistic when it set rates in 2000 and was not being realistic about the costs and uncertainties it faced, he pointed out. Since then, we’ve had bad things happen, fish and wildlife (F&W) funding has been cut, and the tribes perceive that commitments have not been honored, Sheets stated. My clients would say that both BPA and the customers are still being too optimistic and both approaches have TPPs that were not acceptable in the past, he observed. Neither proposal addresses the F&W funding principles made in the previous rate case and both have a very high risk of missing a Treasury payment between now and 2006, Sheets stated. We see the higher risks falling heavily on F&W, he said. Don Sampson raised issues a couple of meetings ago with regard to how you will meet Treaty obligations, implement the Biological Opinion, and the Council's F&W program, Sheets continued. None of the proposals address the need for having higher ending reserves so BPA is healthy going into the next rate period, he added.

On February 25, you heard from a number of customers, who came here to tell you what the SN CRAC would do to their businesses, **Ken Canon (ICNU)** stated. They are very concerned about the outcome of this process, he stated. When you talk about higher ending reserves, we know where that money comes from, Canon said. "It comes from those businesses and their consumers – it's in your pocket or ours," he said. That's a concern for companies that are trying to keep people employed in this region, Canon pointed out. The question is, how do you balance having to meet or defer a Treasury payment with imposing a 40-mill rate, he said. It's a fairly easy answer for a number of my clients; they know the consequence of a 40-mill rate – "they are out of business," Canon stated.

We have to resolve the post-2006 issues at least for some period, probably through the term of our contract in 2011, **Scott Brattebo (PacifiCorp)** stated. Our offer to defer the $55 million in benefits for four years was based on getting to a comprehensive settlement of issues post-2006, he said.

There is the $200 million litigation premium that would go away if there is a settlement and the $220 million benefit that is being deferred with interest, Wright clarified. Is it the IOU position that in addition to the $220 million with interest, you need the benefit defined beyond the current contract period in order to do this deal? Wright asked. With the $220 million plus interest, you'd be revenue neutral, but do you have to be better off post 2006? he inquired.

Marc Hellman (OPUC) explained that based on the OPUC's conversation with Paul Norman, it was clear that the IOUs could lose a portion of their benefits as a result of the deferral, if there is an SN CRAC, and because the cost of the $55 million relates to how rates are set in 2007-11. We would get paid the $55 million for the second five years, but we won't know if that is in addition to what is fair and reasonable otherwise, he said. There has always been "a fair amount of discretion" in establishing the benefits for the IOU customers, according to Hellman. The commission places a lot of value on certainty for the future five-year period and in knowing what the benefit will be, he pointed out.

We have to have some settlement beyond 2006, Brattebo reiterated. The deferral agreements PacifiCorp and Puget signed for FY 03 say that simply eliminating the litigation doesn't eliminate the $200 million, Brattebo said. Our customers were entitled to that money in December 2001, and we agreed to defer contingent on "a comprehensive settlement" associated with the litigation, he explained. I think a long-term solution is the right way to go, Brattebo added. We don't have time to do that right now, but we are willing to talk about going up to 2011, he added.

Lyn Williams (PGE) cautioned BPA about referring to the repayment of the $55 million deferral as "revenue neutral" for IOU customers. Our customer will not be getting the entire $55 million back, she said.

The SN CRAC proposal to set BPA's revenue picture through the remainder of the rate period has the effect of transferring all of the risk from the agency to the utilities and their customers, **Pat Reiten (PNGC Power)** pointed out. That is an entirely unacceptable situation with regard to the incentive for working out the cost cuts, he said. The issue of the offsetting revenues in the PBL internal costs "is a small piece of the overall puzzle," but "our managers know the difference between an expense line and a revenue," Reiten stated. You said you would manage your costs to 2001 actuals, and using the revenue offsets looks like "a shell game" to avoid having to do that, he said. We are not all supportive of crediting revenue to avoid an SN CRAC in lieu of decreasing the LB CRAC, and there is more work to do, Reiten acknowledged. That aside, "around our board table," a proposal to fix the revenue side first and work on cost cuts later doesn't create the right incentives and doesn't work, he said.

Hellman asked whether BPA has committed to the cost reductions outlined in the Saven proposal, and whether the agency is open to a year-to-year consideration of the SN CRAC. Norman offered to go through the cost reductions BPA spelled out in its handout, and Wright said the duration of the CRAC will be an issue in the rate case and remains an open question.

Clark asked how customers could verify at the end of each year that BPA has made the reductions it said it would. Norman said BPA staff has regular meetings with customer staffs to go through the agency's monthly cost statements. We'll keep doing that, he said. How do we hold you to the spending commitments you make in the SN CRAC rate case? Clark asked. We need a commitment that those dollars won't just go back into the bureaucracy, he added. We will lay out the numbers for all to see, and if we aren't adhering to the rate case, people will make it a big problem for us, Norman responded. We understand the problem very clearly, he added. We don't have an adequate verification mechanic and enough transparency with your accounting, Clark stated.

Even if we don't resolve the IOU issues, our TPP for 2004 is equivalent to what you've proposed, Saven said. Yes, if we use $100 million of the ENW refinancing funds, Wright pointed out.

If BPA does not go through with the SN CRAC now and allows us to work on this, it would increase BPA's credibility – we would trust that BPA is going to work on reducing its costs, Lovely stated. The risk is not on BPA if this process does not work out, it is on us, he said. We understand that "in big bright bold red letters," Lovely added. You work on the costs, we'll work on the settlement, and we'll work together on all the other issues to make this happen, Lovely urged.

I don't believe customers will take the risk, Weiss interjected, adding that fish budgets are always under pressure to be cut. If customers are willing to sign on the line that the fish budgets won't change, I could be more supportive, he indicated. Clark pointed out that the customers did not include BPA's proposed F&W efficiencies and cuts in their proposal.

BPA Outlines Risk

Norman said BPA is extremely motivated to work on the $754 million identified by the customers. If we are successful, we won't have much, if any, rate increase next year, he stated. Does the proposal in the FRN automatically reduce the amount of the rate increase as cost reductions are achieved? Mundorf asked. Yes, on a "backward-looking" basis, Norman replied. Mundorf suggested there would be a credibility issue if BPA alone makes the forecasts of expenses, without review, and then makes its own determination about whether reductions are being made. You can reflect what you want to reflect, he stated. That can be remedied in the rate case, Norman responded.

Norman went over a handout that outlined the effects of deferring the SN CRAC process and the "high financial risks" of doing so. We have been working on many of these costs for a long time, he said. Our fundamental concern is for "betting on the come" for things we haven't achieved, Norman stated. While all of the $754 million in cost cuts and revenue increases in the customer alternative should be pursued, none can be counted on yet, he said. If we rely on uncertain financial improvements and do not get them, it could mean financial disaster – a 15 percent TPP or a 59 percent rate increase in 2004, Norman explained.

Even with an SN CRAC in 2004, there is a good chance BPA will need its "last-resort cash tools" just to stay liquid, he continued. If we use $100 million of the ENW refinancing proceeds now, the revenue available in those tools will be that much smaller when the time comes, Norman said. We agree with customers about the seriousness of the region's economic situation, he said. BPA has already lowered its standards with regard to meeting the Treasury payment, according to Norman. In the 2000 rate case, our standard was 80 to 88 percent for five years, which translates to over 90 percent for individual years, he explained. The TPP target in the SN CRAC proposal is 50 percent for individual years, combined with a three-year Treasury *Recovery* Probability of 80 percent, Norman said. If we applied our historical standard, the proposed SN CRAC would be much larger, he pointed out.

BPA has already seen a downgrade in its credit rating from Fitch, and deferring the SN CRAC would likely mean further downgrades, Norman said. Dropping the process now "is perilous" for our credit rating, he stated.

Linc Wolverton (ICNU) pointed out that 120 utilities in the region will be affected "on the other side" if BPA raises rates, and they will see their credit ratings go down. You're transferring the risk to them, he said. These are arguments about why stopping the SN process would be a problem now, they are not arguments to raise rates, Norman replied. Our goal is <u>not</u> to raise rates, it's to get costs down and avoid an increase, he said.

Our credit ratings are interwoven, no question about it, Curtis acknowledged. The ratings are instructive because they provide a view about the reasonableness of certain financial actions, he indicated. The ratings are "a litmus test" of the actions we could take, Curtis added. As I read the Standard & Poors statement (provided by BPA as a handout), it says if we use the debt optimization savings specifically to defer costs, we'll get downgraded, he explained.

The Moody's report says that cost control is the surest way to financial strength, Clark pointed out. Using one-third of the ENW refinancing as a cushion, which will be repaid within the rate period, is a smart option for liquidity, he said. There is no rate in place to assure that the money will be collected to accomplish the payback, Curtis responded.

The rating agencies cite low water conditions as part of the problem, **Larry Felton (Okanogan PUD)** said. What are your assumptions about hydro conditions in the SN CRAC? he asked. For this year, it's the current runoff forecast, which is about 70 percent, and for the remainder of the years, we assume average water, Norman replied.

He moved on to explain an analysis that addressed why BPA feels it needs a multiyear SN CRAC. In the FRN, BPA states it could trigger another CRAC if needed, **Jeff Nelson (Springfield)** said. So BPA's TPP in future years is actually 100 percent because of that, he pointed out.

If BPA went with a one-year SN CRAC or a three-year fixed SN CRAC, the impact on rates would be much greater, Norman replied. He said BPA is not aiming to rebuild reserves and that the customer proposal for a 50 percent year-by-year TPP translates to an 87 percent chance of failure to make the Treasury payment in at least one of the next three years. Saven said he suggested reductions in spending and changes in revenue, but not a TPP standard. We did not advance or assume a 50 percent TPP standard in future years, he stated.

Among other issues, Norman said the year-by-year SN CRAC poses the risk of an extremely high CRAC in 2005 and 2006. He added that BPA must demonstrate to the Federal Energy Regulatory Commission that is has set its rates sufficient to cover costs. A one-year SN CRAC does not do that, Norman stated. If BPA addresses the SN CRAC a year at a time, it creates more likelihood that "a bow wave of financial losses" will be building and pushed out beyond 2006, Norman said. That will make it all the more difficult to resolve the long-term questions, he said.

When the SN CRAC was established, did the agency view it as a multiyear tool? Reiten asked. The intent was to put something in place that would get us back to a reasonable state of health for the remainder of the rate period, Norman replied.

Weiss suggested the BPA and customer view is not that far a part. Your SN CRAC is year-to-year, it's just automatic, and the customers' proposal requires a 7(i) every year, he said. It's not a big difference, so "just settle it and get on with life," Weiss advised. I'll propose again that you do a year-to-year process, make it as simple as you can, start it a little earlier in the year, and have the Administrator make the decision, he said. Someone could do an analysis to determine how early in the year it needs to occur, so you will have the opportunity to recover adequate revenues, Weiss pointed out.

When the SN CRAC was proposed in the (2002 Power Rate Case) settlement discussions, the 7(i) was the forum to resolve the issues we're talking about now – the duration of the increase, the nature of the problem and the fix – we envisioned talking about exactly these things, **Barney Keep (BPA)** stated. This is what the process is supposed to be about, he said.

Norman outlined the status of elements in the customer proposal with regard to cost reductions, deferrals, and revenue improvements (attachment 4). With regard to the use of ENW refinancing proceeds, the ENW board does not currently support the use proposed by the customers, he said. As for the proposed cost reductions, Norman said BPA has already reduced internal costs by $140 million, so to label these "first-round" cuts is misleading. We have also committed to an additional $20 million, which would be included in the customer-proposed $70 million, as part of our commitment to stay at FY01 actuals for net internal operations costs, he stated. Norman indicated that another $50 million in cuts could affect the agency's ability to carry out its fundamental mission.

But compared with 2001 actuals, BPA's expected internal expenditures in FY03-06 are an average of $12 million a year higher, Murphy pointed out. You are talking about "budget cuts," not cost cuts, and that is not the same, he contended.

Norman outlined other proposed costs BPA "is attacking." Some of these may be achievable, but none are done now, he added.

Clark said the issue of trust surfaces again when you consider what Steve Wright asked for in his February 7 letter and the customers' work to come up with a proposal that was responsive. You've seen a genuine effort by customers to reach out and re-establish trust about the agency's spending and the rates our customers have to pay, he said. Help us see that there has been reciprocation, Clark added.

What's sad is that a lot of energy went into a proposal that will work to get us through this painful period, Lovely said. And energies that could have been used to work on the IOU settlement will be deflected to other purposes, he stated. Efforts will be expended in a contentious, tiresome way, when the opportunity exists to build credibility and work together, Lovely said.

I am still hopeful we can get to a positive outcome, Saven responded. I think we have made a compelling case, and I want to hear what Steve has to say about whether we need the SN CRAC, he said.

Administrator's Remarks

I am concerned about getting an IOU/public settlement in place, and "it's a critical piece," Wright stated, adding that he is concerned about resolving major issues, including how big the settlement would be. Wright noted that he is still hearing dissention on some issues, and "this discussion has not given me a lot of comfort" about how quickly they could be resolved. Proceeding with the SN CRAC does not take the pressure off BPA – we have to deal with the cost issues as we go forward, he stated.

I am sympathetic to the argument about the automatic adjustments, so BPA is not allowed to increase costs that will automatically be recovered, Wright said, adding that the agency and customers could work on a remedy for that. I'm impressed with the argument about the need to get the right resources allocated to resolving these other issues, he continued. As for decelerating the start of a rate case, Wright expressed skepticism about a rate period that did not start October 1. If we don't have a rate in place for 12 months, there are equity issues about how it affects different load shapes, and I don't want to spend time and resources coming up with a mechanism for "catch-up" billing, he indicated.

I've reached the conclusion that we have to keep the SN CRAC going, Wright stated. But it has to be done in a way that is responsive to issues that will decrease our costs, he said. If we can get to a resolution on the IOU issues before October 1, great, but if not, it's whenever it happens, Wright indicated. The SN CRAC has to be structured in a away that BPA does not let up on its costs, he stated.

The IOUs are highly motivated to make the customer proposal work, Brattebo stated. I'm confident we can resolve this – we are not dragging our feet, he added.

Clark asked for assurance there will be ways outside the rate case to re-examine BPA's costs. Wright said he would look for processes that could occur in parallel with the rate case to look at cost issues.

This has been a good exchange, and I'm confident you have been listening to customers and customers have been listening to you, **Jack Speer (Alcoa)** stated. But I don't see much coming together on the issues and that disturbs me, he said. The critical issue for me is what we ultimately do with rates, Wright responded. I've heard people say that this is a trust issue and we should stop the rate case, he acknowledged. But I'm not confident we can stop the SN rate case and get to some things that still need to be resolved – I'm still hearing dissention, Wright said, noting that the SN/LB CRAC issues are huge. I am not "hell bent for leather" on raising rates – actually, I'm tired of doing that, he continued. My decision has to do with fiscal prudence, he said. I want to keep going down the path to cut costs and get to a small or no rate increase, Wright added.

We tried our best to make a persuasive argument, Saven said, adding that customers haven't given up on deferring the SN CRAC trigger by some months. You may have heard a mixed response on the IOU settlement and the SN/LB CRAC issues, but I have a high level of confidence we can resolve those, he stated. Our data still show that a reasonable case can be made for what we proposed, and I'd ask you to reconsider, Saven said. I heard what you said, he added, but I don't want to give up on it.

The fundamental issue for me is that we are at a forecast of zero for net revenues this year, and that tells me we've got problems, Wright stated. I hope we'll focus on how we can reduce our expenses – that's what will resolve our problem, he said.

Reiten said he agreed with Saven. There may be disagreements, but we are united in the direction we need to go, he said. We are still worried about having a multiyear SN CRAC mechanism and about achieving the cost cuts, Reiten stated. The multiyear mechanism is an issue in the rate case, and "my mind is not closed," Wright concluded.

Adjourn: 12:20 p.m.